

HARRIS SCHOOL OF PUBLIC POLICY
UNIVERSITY OF CHICAGO

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Managing Globalization

I. Introduction

A. Glad to be able to meet with you this evening.

(Recognize Chris Theriot, student mentee)

B. As you may know, taught at Kellogg.

1. I hope you won't hold that against me.
2. Always enjoy returning to the classroom.

C. Particularly flattered to have drawn an audience today.

1. Approaching mid-terms.
2. Will keep my comments light.
3. Let's make it as interactive as possible.

D. Quick overview of my remarks this evening.

1. Background on the Federal Reserve.

2. Regional interest/activities of the FRB.
 3. Chicago's role in international business and recommendations for expanded regional efforts.
- E. Should note that I would be pleased to take your questions/comments.

Again, hope to have an interactive discussion.

II. First, I'd like to take a few minutes to provide some background on the Federal Reserve and its regional structure.

A. I think that will help put my remarks in context — how you see the world depends on where you sit.

B. The Fed has a decentralized, regional design.

That makes it a very unusual central bank.

1. That design is important because it facilitates effective, long-term monetary policy.
2. The Fed's mission is to foster a safe and sound financial system and a healthy, growing economy.
3. Specifically, we formulate monetary policy, we supervise and regulate banks, and we provide financial services to banks and the U.S. government.

C. Congress created the Fed in 1913 with the structure that balances the public and the private and the central and the decentralized.

1. This system of checks and balances still exists. The 12 regional Reserve Banks have a mix of public and private features.
2. The governing board in Washington, D.C. is comprised of seven public officials appointed by the President and approved by the Senate.

D. Congress insulated the Fed from day-to-day political pressure. Why?

1. The reason is that there is always the temptation for elected representatives to “gun” the economy periodically. That's appropriate at times. But, you need to do it in response to the business cycle — not the election cycle.
2. The central issue is balancing short-term gains against long-term considerations.
3. To help the Fed focus on the long-term, Congress provided 14 year terms for the Board of Governors.
4. Congress also freed the Fed from depending on appropriations to meet its expenses.
 - Congress does review our budget, however.

- And we turn over more than 90 percent of our earnings to the Treasury every year.
5. So, we're insulated from political pressure, but we're accountable to Congress and the American people.
- E. The Chicago Fed and the other Reserve Banks have a number of private sector characteristics.
1. For example, each Reserve Bank has a board of directors.
 - a. Each board consists of leading private citizens in the region.
 - b. The directors are responsible for appointing Reserve Bank presidents, with the approval of the Federal Reserve Board in Washington.
 2. And, as I mentioned, the Reserve Banks compete in the marketplace, selling financial services such as check processing.
- F. The Federal Open Market Committee, or FOMC, is the best example of the Fed's checks and balances. It performs the Fed's most important function, formulating monetary policy.
1. The FOMC is made up of seven members of the Board of Governors and the 12 Reserve Bank presidents, five of whom vote on a rotating basis.
 2. I rotate annually with the president of the Cleveland Fed, and I am not serving as a voting member this year.
 3. And, all the Reserve Bank presidents receive a constant flow of input from beyond the Washington "beltway" because of our regional structure.
- G. So, our regional structure has two major advantages.
1. It insulates us from narrow influences.
 2. And it helps us gather information and ideas from all over the country.
 3. The Fed's structure is vital for developing effective policy. I think our economy is in solid shape due in part to the Fed's ability to take a longer-term view.
 4. Our structure helps us maintain a delicate balance. It helps us focus on policy, not politics.
- H. At the Chicago Fed, we have found it useful to share our regional research and analysis by conducting and organizing studies concerning the Midwest economy.

III. For example, the Midwest Assessment Study

- A. In cooperation with national and regional researchers, the Federal Reserve Bank of Chicago began an assessment of the Midwest economy in late 1995.
- B. The project's primary mission was to document the dramatic turnabout in the region's fortunes

from the early 1980s and take an in-depth look at the underlying changes which have resulted in the turnaround.

- C. As I mentioned, our study took a close look at the region's remarkable turnaround.
 - 1. Why have we prospered in recent years? Is our success due to external factors that the region can't control, like a declining dollar?
 - 2. Or is it due to internal factors, such as productivity improvements?
 - 3. In other words, were we lucky or were we good?
- D. First, let me provide some background on the study. Why did the Chicago Fed undertake this effort?
 - 1. One reason is that we're a regional institution — uniquely positioned to study the Midwest and communicate information to policymakers.
 - 2. This study also helps the Chicago Fed do a better job in contributing to national monetary policy by enhancing our understanding of the Midwest economy.
- E. Our study focused on the five states that make up the Fed's Seventh Federal Reserve District — Illinois, Iowa, Michigan, Wisconsin, and Indiana.
- F. We used an open and cooperative process, holding a series of workshops featuring leading experts who contributed their time to present research on a wide range of issues.
- G. In this way, we were able to bring many voices, ideas, and information to the table — over 200 participants took part.
- H. To help provide guidance to the effort, we established an advisory group which included the governors of the five Seventh District states as honorary members.
 - 1. The group also included representatives from business, academia, labor, and not-for-profit organizations.

IV. Study Findings

- A. I'd like to give you the flavor of our findings. It's easy to forget now, but the Midwest economy is one of the surprise stories of the nation.
- B. As you know, the Midwest was known as the Rust Belt back in the early '80s. At that time, our economy lay in shambles — at the bottom of the steepest recession since the Great Depression.
- C. One of five Midwest manufacturing jobs disappeared from mid-1979 through '82. Unemployment in the region was almost three percentage points above the nation. People had written our epitaph.

- D. Today, the Midwest unemployment rate is almost a full percentage point below the nation (3.8% in March vs U.S. 4.7%).
- E. During our study, we looked at a number of factors, such as:
1. Activities by private sector firms
 2. Government policies
 3. And external forces, such as changes in the value of the dollar
- F. What did we find? Was the Midwest lucky or good? Well, it was both lucky and good, as it turns out. But the most important factor was that we were good.
- G. The main reason for the Midwest's success was its willingness to re-invent itself.
1. The Midwest received a wake-up call. The region found itself facing intense competition — competition from other countries and competition from other regions in the U.S.
 2. The Midwest responded to the challenge and initiated a painful, broad-based restructuring.
 3. Midwest producers reduced costs, created new product lines, and made remarkable productivity enhancements.
 4. A fact we found interesting was that the Midwest renewal was already underway even during the dark years of the 1980s.

Transparency – figure #1

- H. And the source of the recovery? Our old mainstays—basic manufacturing and agriculture. These economic sectors led us down into the valley — and they're leading us up the hill.
- I. We haven't changed what we're doing. But we're doing it much more efficiently — at a world class standard.

Transparency – figure #2

- J. Today, the Midwest is still heavily dependent on manufacturing and agriculture, despite all the changes to its economy.

Transparency – figure #3

1. For example, the Midwest's share of personal income derived from manufacturing jobs was 27 percent in 1996.

Transparency – figure #4

- K. The auto industry provides a good example. It's actually reconcentrating in the Midwest.
1. During the last 17 years, many auto plants have shut down — nine in the Midwest. But 13 new plants have opened here [in the Midwest].
 2. 31 of the 58 auto assembly plants in the U.S. are now in the Midwest. The auto industry is actually more concentrated in the region now than it was back in 1979.

Transparency – figure 5

- L. Manufacturing is leaving the cities. Where is it going? To rural areas, in many cases. Manufacturing in rural areas has grown in recent years, unlike in large urban areas.
- M. The major challenge facing rural areas is related to ongoing productivity improvements in agriculture. That's an absolute necessity in an increasingly global marketplace. But such productivity can translate into fewer farms and farmers, and declining population for many farm towns.

Transparency – figure #6

- N. The Midwest is seeing a decline in the number of farms and the emergence of larger and larger farms. That's a key issue as the region looks to the future.
- O. A key advantage for the Midwest is its increased competitiveness. This is highlighted by research by Chicago Fed economists.
1. According to common wisdom, the Midwest benefited quite a bit from the declining dollar, which made its exports cheaper for overseas buyers.
 2. This is a logical conclusion, given the results of studies that looked at the value of the dollar relative to currencies of the nation's major trading partners.
- P. Our economists took a different approach — a regional approach — and looked at the value of the dollar relative to currencies of the Midwest's major trading partners.
1. Following the 1985-86 period when the dollar fell sharply, our economists found that the dollar then actually appreciated from 1987 to 1996.
 2. In other words, the Midwest did not have a built-in price advantage from the weaker dollar. It appears that the Midwest succeeded because of better products and prices, not just because of external factors such as the performance of the dollar.

- Q. Our success in the global marketplace is a good sign for the region's future.

Transparency- figure #7

1. Exports now account for a much larger share of the U.S. economy — about 13 percent as compared to only 7 percent in 1987 (based on real GDP).

2. In the last few years, exports from the Midwest have grown even faster than for the nation. That reflects the fact that we tend to make products that other countries want — things like transportation equipment, food processing machinery, electronic equipment, pharmaceuticals, corn and soybeans, and steel and steel products.
 3. Developing countries need these products to establish new industries and make their existing industries more competitive.
 4. That's very good news for the Midwest. Because developing countries — particularly in Asia (East/Southeast, excluding Japan) and Latin America (Central/South, Mexico)— are where the growth is.
 5. A quarter of a century ago, less than 30 percent [29 percent] of U.S. exports went to developing countries. In 1997, these same countries absorbed almost 40 percent [37.9 percent] of U.S. exports.
 6. This is a trend that the Midwest is well positioned to take advantage of — because of its products, and because of its renewed competitiveness.
- R. Thus, we concluded that metropolitan areas are perhaps the most cohesive and important “regions” or areas of geography on the world economic stage today.
1. As we become more global, metropolitan areas become more important.
- S. This means that greater Chicagoland must:
1. Present itself well to the global community as a single entity.
 2. So too, the region's public and development policies must be fashioned so as to put its “house in order.”
 - a. Of course, a proactive set of policies, along with strong private-public partnerships does not mean that government should be over-intrusive in its policies.
 - b. Accordingly, effective economic development directions must be led by private market initiatives, while development policies should be designed to maintain a strong general business climate and not a planned or targeted set of industry-specific policies (not industrial policies).
 - c. Nonetheless, local policies and collective action have concurrently become all the more important to economic growth.
 - d. Metropolitan areas such as the CMA have become cohesive and highly populated entities, and fierce global competitors.
 - e. Nearly 80 percent of U.S. population now resides in metropolitan areas. Provision of residential public services and a high quality of life is a stiff challenge to public sector governance.

- f. Moreover, the larger of these metropolitan areas are the domicile of some of the most sophisticated segments of the economy—finance, legal, corporate administration, and business services.
- g. Just as private companies have needed to become smarter and leaner, regions and their strategic policies in support of business need to follow suit.

V. Now that we have taken a look at the System and the Region, let's discuss the city.

- A. Chicago has been a national center for commerce and industry for over 100 years.
- B. Did you know that:
 - 1. Chicago is home to 34 of the Fortune 500 companies?
 - 2. We have 8 million residents and 200,000 technically skilled workers.
 - 3. 1.2 million college graduates and 500,000 post graduates.
 - 4. We have the world's busiest airport.
 - 5. And, we are the world capital of trading and risk management.
- C. Chicago metropolitan area is poised to become a major player in the global economy.
 - 1. In 1996, \$22 billion in exports were shipped from Chicago-based firms to markets all over the world.
 - 2. Home to 1,000 prominent multinational corporations.
 - 3. Because of Chicago's central location in the American economy, its extensive transportation facilities and the quality of its labor force and cultural institutions, the region has attracted an increasing number of foreign-owned production, distribution and sales facilities.
- D. Rich ethnic mix, vast array of foreign financial institutions and consulates and a surge of tourists from abroad have given the metropolis a vibrant international character.
- E. Emergence of the global economy has meant intensified competition not only between American cities, but within an international arena.
- F. Opportunity for Chicago
 - 1. Chicago has the elements needed for continued growth as a center of international business.
 - a. Yet, we must coordinate our efforts and aggressively pursue international opportunities.

G. Chicago's strengths

1. Existing strength in export markets and industry sectors provides a sturdy foundation for business development efforts.

H. Attracting foreign investment to the region.

1. I mentioned that more than 1,000 firms have operations in the Chicago area because of two key locational advantages:
 - a. O'Hare Airport (provides worldwide access).
 - b. Chicago's proximity to major markets and industries.
2. Yet, the major investments of the 1980s have slowed down as other areas attract foreign firms.
 - a. Trend can be reversed with commitment to a proactive strategy and comprehensive program.
 - b. Cities such as Atlanta and Houston provide red-carpet service to interested companies.
 - c. To showcase its strengths, Chicago must adopt a similar approach that is responsive to the interests and needs of companies from abroad.

I. Expert intermediaries

1. Person-to-person contact is essential to international business success, and Chicago has the experts that can help business develop those global relationships.

J. Marketing Chicago and the world

1. Chicago has emerged as an international city by virtue of its central location and extensive transportation infrastructure.
2. We must educate Chicago businesses on export possibilities.
3. As competition from other areas increases, proactive marketing efforts will have to be launched to enhance our international status.
 - a. Enhance current foreign links including those made by state trade offices and the city's Sister Cities program.
 - b. Coordinate and publicize local programs about international business.
 - c. Connect with international visitors at O'Hare, trade shows and special events.

K. World Business Chicago

1. To address these issues, the Civic Committee of the Commercial Club, in partnership with the Chicagoland Chamber of Commerce is launching a new organization, World Business Chicago.

- a. Recently joined the board of directors.
 - b. The overall approach of World Business Chicago is to be a resource to foreign companies and the experts who advise them.
- L. Hopefully, the Chicago Fed will be considered a resource of information for World Bank Chicago as well as other organizations and the public at large.
- M. How well metropolitan Chicago competes with other global “cities” will depend on its collective strategies that support its private market economy—its economic development policies,
- its entrepreneurial programs and supports,
 - its workforce strategies, and
 - its information and promotional efforts.
- N. From the time of its earliest settlement, Chicago has been a city built on commerce and industry. For more than a century, it has been a dominant industrial center in the U.S. economy. In order to maintain this salient position, the Chicago metropolis must now become an assertive, commanding player in the global market.

VI. Conclusion

- A. I’m pleased to have been invited to talk to you this evening about our central bank, our region, and our city.
- B. Thank Chris for the invitation.
- C. I’d be happy to take any questions, or open the floor to general discussion.